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No. 91-886

In The
Supreme Court of the United States
October Term, 1991

BOB REVES, ROBERT H. GIBBS, and
FRANCES GRAHAM, As Representatives Of
A Class Of Note Holders,

Petitioners,

v.

ERNST & YOUNG,

Respondent.

On Writ Of Certiorari To The
United States Court Of
Appeals For The Eighth Circuit

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Does section 1962(c) of the RICO statute - which makes it "unlawful for any person employed by or associated with any enterprise . . . to conduct or participate, directly or indirectly, in the conduct of [the] enterprise's affairs through a pattern of racketeering activity" - require proof that the defendant control the management or operation of the enterprise?

PARTIES TO THE PROCEEDING BELOW

In addition to the parties listed in the caption, parties to the proceeding below included Thomas E. Robertson, Jr., as trustee of the Farmer's Co-Op of Arkansas and Oklahoma, Inc., and Robert C. Cloar, class counsel.

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OPINIONS BELOW

The opinion of the U.S. Court of Appeals for the Eighth Circuit is reported at 937 F.2d 1310, and is reproduced in the Joint Appendix ("JA") at JA 226-352. The summary judgment opinion of the U.S. District Court for the Western District of Arkansas is unreported and is included in the Joint Appendix at JA 1-222.

JURISDICTIONAL GROUNDS

On June 27, 1991, the Eighth Circuit affirmed in part and reversed in part the judgment of the district court. On August 29, 1991, the Eighth Circuit denied Ernst & Young's petition for rehearing. On November 27, 1992, the Class timely filed a petition for a writ of certiorari. By order dated February 24, 1992, this Court granted the Class' petition. (JA 353.)

This Court has jurisdiction to review the judgment below by writ of certiorari pursuant to 28 U.S.C. § 1254(1). The courts below had federal jurisdiction pursuant to 28 U.S.C. § 1331.

STATUTE INVOLVED

The statute involved in this petition is 18 U.S.C. § 1962(c) of the Racketeer Influenced and Corrupt Organizations Act, which provides:

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

STATEMENT OF THE CASE INTRODUCTION

The Eighth Circuit provides an accurate overview of the facts in (JA 231-69),¹ and we adopt its definitions.² However, as the Eighth Circuit was dealing with three sets of appeals and over twenty issues, it could not, as we will below, detail the evidence critical to three pending factual issues: what were the Co-Op's "affairs"; how Arthur Young "participated" in the "conduct of" those "affairs"; and whether anyone other than Arthur Young initiated, encouraged, or assisted the securities frauds at issue.

¹ Citations in this brief observe the following formats. Citations to the Joint Appendix are in the form "JA ____." Citations to the Court of Appeals Joint Appendix are in the form of "CAJA ____." Citations to the trial transcript are by volume and page in the form "Trans. ____:____."

² After all trial evidence was admitted, plaintiffs moved for and the judge granted reconsideration of the pre-trial summary judgment on RICO issues. The trial court then reaffirmed its earlier ruling based on the combined trial and pre-trial record. (Trans. XV:48-51.)

THE CO-OP'S AFFAIRS

The Co-Op was a nonprofit association open to all farmers in eastern Oklahoma and western Arkansas. The Co-Op bought farmers' grain and sold them agricultural necessities ranging from seed to tractors. Farmers could become Co-Op "members" (for a small fee) and then be credited with an allocable share of its annual "savings" (profits).

One service the Co-Op provided its rural members was a handy place to make an interest-bearing investment while selling grain or buying fertilizer. On its premises, the Co-Op sold notes, payable on demand, earning interest slightly in excess of bank rates. The Co-Op's financing came primarily from these notes, which in 1981-84 totalled about \$12 million and provided 65-75% of the Co-Op's total financing. (See CAJA 231-33, 239, 262, 326.)

THE CO-OP'S MANAGEMENT

The Co-Op's Board of Directors consisted of nine persons, all farmers, few with more than a high school education, who served for nominal pay as a community service. (Trans. III:188-90; XI:252-53, 271; XII:140, 232.) After the Co-Op's general manager (Jack White) and its internal accountant (Gene Kuykendall) were convicted of self-dealing, theft of Co-Op funds, and falsification of Co-Op records in January 1981,³ a "reform" movement arose

³ The indictment, technically for tax fraud, charged White with a "course of self-dealing" between 1973 and 1979, "using

(Continued on following page)

in the membership to replace the old directors as they came up for re-election. (Trans. XII:23-24.) As a result, the members replaced four incumbents in contested elections at the spring 1981 meeting. (Trans. XI:251-52; XII:188.)⁴ At the board level, the newest directors by a 5-4 vote replaced the incumbent president (an "old" director) with a "new" director in 1982. (Trans. XI:285-86.)

The General Manager was in effect the Co-Op's chief executive officer. (See JA 231, 253-54.) In April 1982, general manager White's conviction was affirmed and he went to prison. (Trans. XII:25.) After that, in another split vote, the Board demanded (and got) White's resignation.

(Continued from previous page)

moneys from the [Co-Op] in excess of One Million Dollars, on more than one occasion, which enriched JACK E. WHITE; and using [Co-Op] moneys . . . which enriched corporations in which JACK E. WHITE had a financial interest [or] . . . benefited [his] associates . . ." and charged both White and Co-Op auditor Kuykendall with having in many specific ways "agreed to conceal and disguise the true nature of the [self-dealing] transactions on the [Co-Op] books [and] records. . . ." (CAJA 893-94.) Affirming the conviction, *United States v. White*, 671 F.2d 1126, 1134 (8th Cir. 1982) (CAJA 906, 914) stated the essence of the case as: "The record clearly demonstrates that White and Kuykendall manipulated the Co-Op's finances to serve their own personal ends, and that they distorted the Co-Op's records"

⁴ Since another director had been newly elected in 1980, starting in spring 1981 five of the nine directors had not been in office during the 1973-79 activities for which White had been convicted. This majority increased to 6-3 and 8-1 as more incumbents were thrown out at the 1982 and 1983 elections. (CAJA 231-32, 362-65.)

(See Trans. XII:25-27.) The Board replaced White with an outsider, Fred Howard, in August 1982. Because Howard knew nothing about the Co-Op's financial condition, he wanted a special mid-year audit before he took office. To save the cost of such an audit, the Board agreed that Howard was indemnified and not responsible for actions and records until 1983. (Trans. XI:281-82.) The resolution effecting this indemnity was given to Arthur Young. (Trans. XI:282-83.)

In the period *between* White's jailing and Howard's hiring, i.e., when the Co-Op had no functioning general manager, Arthur Young first met the new board and presented Arthur Young's proposed 1982 report (for year-end 1981). (The sequence of events each year is: outside auditors present report; directors approve report; annual meeting held to present report and elect some new directors. (Trans. XI:255.)) Thus, a new director could wait a year to first meet the auditors. In this case Arthur Young first met with the directors elected in March 1981 on April 22, 1982, when Arthur Young had drafted its proposed report. (Trans. XI:254-55.) Also *between* White's jailing and Howard's hiring, Arthur Young had numerous meetings with the Board, concluded its audit, and finalized its 1982 report.

The Co-Op's only inside accountant, Kirit Goradia, used the title "office manager." His role (and disclaimer of responsibility) is summarized by the Eighth Circuit. (JA 253-55 & n.10 (Goradia refused to verify accuracy of, or take any responsibility for, Co-Op records).)

The Members and Investors were told about the Co-Op's assets, liabilities, and profits or losses once each

year at an annual meeting. This was traditionally done by the outside accountant for the Co-Op, a tradition continued by Arthur Young. A condensed financial statement was generally passed out at or before the meeting, another tradition continued under Arthur Young. The meetings were in the evening, once a year, and covered many issues other than finances.

THE ROLE OF ARTHUR YOUNG: 1981-1983

1981 Criminal Trial. When White and Kuykendall were indicted in September 1980 (*see supra* note 3), they hired the law firm of Ball & Mourton both to defend them and to represent the Co-Op's interests. (The Co-Op eventually paid all bills.) Ball & Mourton, which specialized in tax fraud cases, hired as defense experts Russell Brown & Co. (which later that year merged into Arthur Young). The head of the firm, Harry Erwin, and the head of its tax department, David Ray, testified for the criminal defendants. (Trans. IX:155.) Ray was present for the entire trial and had to understand the whole case against White and Kuykendall since he had responsibility for summing up the testimony. (Trans. V:168-69.)

White Hires Arthur Young. Between White's 1981 conviction and the 1982 affirmance (and his jailing), White, with Ball & Mourton, interviewed trial witness Erwin and other Arthur Young representatives to be the Co-Op's new auditors. (JA 238.) The Co-Op hired Arthur Young in November 1981. (JA 238; CAJA 1093.)

The Gasohol Plant. Arthur Young soon confronted what they promptly recognized as another example of self-dealing and falsified records implicating not only

their recent clients White and Kuykendall but also Ball & Mourton, the firm that had referred White and the Co-Op to Arthur Young.

To understand what happened, it is necessary to go back to early 1979, when White and an outsider, Ed Dooley, had invested \$125,000 each in a gasohol plant. (JA 233; CAJA 1124-32.) On October 30, 1979, White bought Dooley out for \$125,000, (JA 233; CAJA 938-40), and borrowed \$250,000 from Citizens Bank, of which White was Chairman and a major stockholder. The gasohol corporation later borrowed another \$300,000 from Citizens. (CAJA 934-37.) In 1980, White began borrowing from the Co-Op, owing it \$4.1 million by December. (JA 234; CAJA 967-73.) Thus, by December 1980, White owed his bank \$550,000 and the Co-Op \$4,100,000.

The gasohol plant went into production in April 1980 and by December 1980 had the following problems: grain prices rose, oil prices dropped, equipment did not work, the plant only operated at 20% capacity (JA 240), pollution authorities shut down the plant and required purchase of new expensive abatement devices, and the Republican presidential candidate (who won in November 1980) opposed the previous Democratic administration's tax breaks and subsidies without which gasohol was not a viable product. (*See* Trans. II:33-34.) At year-end 1980 the plant was worth between \$500,000 and \$750,000, according to one appraiser; between \$450,000 and \$1,500,000, according to another. (JA 245 n.7.)

After White was indicted and before he went to trial, White told Ball & Mourton of his gasohol problems and

Ball & Mourton proposed a "friendly lawsuit" by the Co-Op against White to: cause the Co-Op to pay the \$550,000 to White's bank; cancel White's \$4.1 million debt to the Co-Op; and transfer the gasohol plant to the Co-Op. (CAJA 923-27.) Between December 12 and 19, 1980 the Co-Op filed "its" complaint; White answered (with a denial); and the parties "settled" by agreed decree. The decree was not filed until five weeks later, after White's trial ended. (CAJA 928-31.) The decree was approved by a judge who heard no evidence because the case was described as "settled." (Trans. IX:79-84.) The friendly lawsuit pleadings and many key corporate records of the gasohol plant were given to Arthur Young and maintained in its workpapers. (See *infra* note 6.)

Arthur Young Decides How To Book The Gasohol Plant. If the Co-Op bought the gasohol plant from White, as the friendly lawsuit complaint and decree provided, then the accounting rules inflexibly required the Co-Op to record the plant at fair market value as of the acquisition date. (JA 242-44.) Since that value was less than \$1.5 million (and probably less than half that), had it been so booked the Co-Op instantly would have become insolvent (*i.e.*, had a negative net worth). That would have caused a "run" by holders of demand notes, which would have caused all financing to be withdrawn and the Co-Op to have declared bankruptcy. (JA 245.)

Those developments, on the heels of the recent convictions, could have led to investigations, indictments, disbarments, license revocations, and multi-million dollar civil liabilities not only for Arthur Young's clients White and Kuykendall, but for Arthur Young's referring counsel

Ball & Mourton. With the "new" reform directors in a potential majority, White in jail, and a new general manager yet to be hired, Arthur Young had fundamental decisions to make about who to consult and what to advise them.

Arthur Young decided to consult no one, and instead, unilaterally decided to book the plant at \$4.5 million, between 300% and 900% more than its true value, based on three critical business conclusions (discussed in the next three sections). Arthur Young never discussed these conclusions with the directors (or, when he was hired later, the new general manager Fred Howard). (Trans. XI:267-73; XII:145-48, 192-93, 236-40.)⁵ As a result of booking the gasohol plant at \$4.5 million (rather than the true value – under \$1.5 million), the Co-Op showed an apparent positive net worth of \$2.6 million (at year-end 1981) and \$1.4 million (at year-end 1982). (JA 245-47, 256; see also Trans. IX:175 (Arthur Young prepared the financial statements).)

Arthur Young Claims It Did Not Book The Plant At Value Because The Co-Op Did Not Buy It. At trial, to justify this accounting treatment, Arthur Young had to claim that the Co-Op did *not* acquire the gasohol plant but always

⁵ Indeed, at its first meeting with the Board on April 22, 1982, Arthur Young did not even reveal the friendly lawsuit. The "new" directors learned about the suit only when one, pursuing a rumor, went to court himself, searched the court files, found the pleadings, and showed them to the other "new" directors at a board meeting. (Trans. XI:261-68.) That was the first any of them knew of the friendly lawsuit. (Trans. XII:192-93, 236-37.)

owned it. Arthur Young claimed it believed that the "economic substance" of the transaction made this true. (See Trans. IX:214-15.) Plaintiffs claimed Arthur Young could not have believed that, invented it to avoid the correct accounting treatment, and lied about its reasons for doing so. The jury, having been instructed that Arthur Young could be found guilty only if Arthur Young "originated" the fraud, had "no honest belief in the truth of the [Co-Op's financial] statements," "acted with actually fraudulent intent," and was proven wholly lacking in "good faith" (Trans. XVIII:71-81), agreed with plaintiffs.

Judge Waters explained Arthur Young's critical role in reaching this key conclusion (JA 136-38 (emphasis in original)):

[A] jury might reasonably find that Arthur Young's audit report was dictated by the *result* it wished to achieve

The records may permit a reasonable jury to find that the auditors adopted a blatant fiction - that the Co-op owned the entire plant at its inception in May, 1979 - in order to justify carrying the asset on its books at its total cost, as if the Co-op had built it from scratch. The auditors indulged this fiction despite being aware of the Chancery Court decree which said it assumed ownership of the plant in February, 1980, at a time when it was substantially completed. . . . A reasonable jury could conclude that the Arthur Young defendants picked an acquisition date out of the air that they could "justify," in order to record assets onto the books in a way that would make White's management "look better."

If that is what Arthur Young did, they did so without consulting Fred Howard (who was not there yet) or the

Board, (Trans. XII:145-47, 192, 236-37), and in contravention of all available Co-Op records, including even what Ball & Mourtou and White had put in the friendly lawsuit pleadings.⁶

Arthur Young Inflates The "Cost" Of Construction. If the Co-Op did not buy the plant but built it, the Co-Op

⁶ Arthur Young's workpapers (CAJA 1099-1173) concluded: "The Co-Op acquired White Flame by the assumption of a \$250,000 debt of White Flame's sole stockholder [White] . . . via a court order which set the acquisition date in February, 1980." (CAJA 1234, 1239, § V(13b).) The workpapers contained the "friendly lawsuit" decree which purported to transfer title to the Co-Op and, tracking the complaint (CAJA 923-27), recited that Dooley and White were the original owners, that White had bought out Dooley, and that White from October 1979 to February 1980 was sole shareholder. Arthur Young's workpapers also contained documentation that: the gasohol plant company was incorporated in 1976 by Ed Dooley, a man unrelated to the Co-Op; he named it "Big D [for Dooley] Enterprises"; on May 1, 1979, he and his wife, its sole officers, and Jack White met to change the name to "Big D&W [for Dooley and White] Refining and Solvents Co., Inc."; shares were then issued to White and Dooley; August minutes showed them to be its sole shareholders, directors, and officers; the corporate tax form showed each owned half; each contributed \$50,000 in June and \$75,000 in July, the company's entire capitalization; White bought Dooley's interest on October 30, 1979 for \$125,000, after which the corporate name was changed to White Flame; the tax return stated White was sole shareholder at December 31, 1979; the Co-Op's 1979 tax return and audited financials showed no interest in the gasohol plant; and the Co-Op's 1980 audited financials stated that White Flame was "acquired in February 1980." (CAJA 1099, 1106-24, 1133-35, 1142, 1150-56, 1162-71, 1185, n.5; Trans. II:17.)

needed to calculate its "cost" of construction in order to determine the proper book value. Kuykendall's audit at December 31, 1980 had used a cost figure of \$4,393,242.66. Normally, an accountant would start with that number and add to it any post-1980 costs to get the 1981 number. But Arthur Young determined they could not use Kuykendall's figure, laughed about its unreliability, and put quotation marks around the word "audit" in referring to what Kuykendall had done. (CAJA 1190; Trans. IX:178-85; XI:96.) Further, to use Kuykendall's number, Arthur Young had to talk to him about how he had reached it, which they never tried to do. (Trans. VII:259; XIV:210.) Nevertheless, Arthur Young used for its December 31, 1980 "cost" figure the exact same \$4,393,242.66 (which rose to \$4.5 million with the addition of certain construction costs and capitalized expenses). (JA 241-42.)

To explain this, Arthur Young auditor Drozal testified that he had conducted his own "independent" review of the gasohol plant books and, by a remarkable coincidence, happened to arrive at the same exact number, \$4,393,242.66. (JA 138-40; Trans. IX:185-86.) He adopted that story before he knew that Kuykendall would admit that he had "essentially invented" the asset number, which he had deliberately inflated to avoid showing a "tremendous big loss." (JA 139-40.) Specifically, Kuykendall later admitted he and White originally kept a second set of books which fraudulently inflated asset values by "capitalizing" ordinary operating expenses instead of deducting them from profits. After their indictment, Kuykendall and White feared this looked too blatant, so they created a *third* set of books capitalizing only 70-90% of each expense, using totally arbitrary amounts, and

keeping about 80% of the original fraudulent inflation of assets. (See Trans. VII:244-59.) Kuykendall then "audited" his own numbers in one day, claiming he had used "a hybrid accrual method," a term that he made up. (Trans. VII:261-63; CAJA 1201.) Arthur Young knew this method was fictional and found the whole "audit" humorous. (Trans. IX:178.)

To again quote Judge Waters (JA 140-41 (emphasis added)):

A reasonable jury would be justified in concluding that Arthur Young did not independently arrive at Kuykendall's figure, and that the odds against their having done so were astronomical. A reasonable jury could find that *Arthur Young had no actual belief in its audit report: either in the cost figure at which to record the gasohol plant or in the fiction which they employed to justify carrying the asset at cost. A reasonable jury could conclude that the determination to carry the asset at cost rather than value was critical to the presentation of the Co-op as "a going concern."*

If Arthur Young witnesses lied at trial about how they came up with their inflated cost figure, the reasonable inference is that Arthur Young lied about and concealed their methods at earlier times from everyone else at the Co-Op.

Arthur Young Avoids Writedown. Another obstacle remained. Even if Arthur Young was justified in using the inflated \$4.3 million figure as the plant's cost of construction through December 31, 1980, and even if it might be

able to avoid the iron rule that it use value, not cost, for acquired property, accounting rules still required the plant to be "written down" to the *lower* of cost or value if the cost was not likely to be recovered through future operating profits. (See Trans. XIV:191-95, 201-09.) Arthur Young understood this; its workpapers, which identified and analyzed this issue, concluded that "the plant could not produce enough volume to provide sufficient income to ever cover expenses of manufacturing and operations." (CAJA 1238, § V(4).)⁷

However, Arthur Young decided not to recommend a writedown to value. When Arthur Young discussed the issue with the directors, Arthur Young said that "in the future" the Co-Op "might" have to write down the plant's book value, but that no write down had to be considered in 1981-83. (Trans. XI:277-78; XII:147-48, 240.)

Related Party Transactions. Arthur Young conceded that it had to give extra scrutiny and care to any "related party transaction," which included any dealing between White and the Co-Op. While White was general manager this duty was intensified by White's conviction. Yet Arthur Young did not consider the gasohol plant purchase a related party transaction. (Trans. IX:169-70, 201-05; CAJA 1239.)⁸ Arthur Young audited many

⁷ The workpapers showed costs of production exceeding selling price by at least \$1/gal. and by 20-35 cents/gal. even ignoring interest and overhead. (CAJA 1220.) In other words, if someone gave you the plant and did all your administrative work free, you still would be better off giving it back than trying to run it.

⁸ Arthur Young deemed the Co-Op a "close monitoring client." (CAJA 1234, 1237-40, § V.) That is Arthur Young's term for a client that can cause Arthur Young embarrassment and financial exposure. (Trans. IX:205-06, XI:116.)

related-party transactions other than the gasohol plant. We discuss one below because it bears on the degree of Arthur Young's involvement in the Co-Op.

At White's criminal trial, White tried to justify getting money from the Co-Op by testifying that he bought (a) \$1.5 million in bonds payable by the Co-Op at 8% interest with (b) proceeds of a \$1.5 million *no-interest* loan from the Co-Op (CAJA 895); thus the Co-Op owed him \$120,000 annually. In investigating this related-party transaction after the conviction, Arthur Young discovered that on the \$1.5 million loan, White had actually signed a promissory note agreeing to pay the Co-Op interest of 10% (\$150,000) per year. (CAJA 1095, 1227; Trans. IX:170-73; XI:258-60.) Obviously this discovery raised all sorts of legal and ethical questions about perjury, subornation, and fraud by Arthur Young's recent clients White and Kuykendall and the source of Arthur Young's business, Ball & Mourton. It also created a large unbooked debt that White owed the Co-Op. However, rather than tell the Board about this discovery or mention it in the Co-Op financial statements, Arthur Young stuck the promissory note back in the file and acted as if it did not exist. (CAJA 1094; Trans. IX:172-73.)

To Arthur Young's dismay, however, one "new" director diligently uncovered the note and brought it to Arthur Young's attention, seeking guidance. Arthur Young told the director it was "too late to do anything," and persuaded him that raising it at a Board meeting would only "open a can of worms." (Trans. XI:258-60.) Since the director followed Arthur Young's advice, no

other "new" director ever learned of the note. (Trans. XII:145-49, 194.)

What Arthur Young Told The Investors In 1982. Investors (and other Co-Op members) learned of the Co-Op's financial condition at its annual meeting, when they received "condensed" financial statements. (JA 248-49; see also CAJA 230-31 (condensed statements also distributed to members with Notice of Annual Meeting).) The 1982 condensed statement listed \$7.5 million in "Land, Buildings, Equipment and Vehicles," but did not disclose that this included the gasohol plant valued at over \$4 million. (Trans. XII:112-13.) Moreover, the statement inconsistently did *not* include the gasohol plant's \$1.3 million 1982 loss, thereby allowing the Co-Op to show a \$154,012 profit (net savings) rather than a loss of over \$1 million. (See CAJA 240.) The Co-Op mailed a draft condensed statement to Arthur Young and received it back, without any changes, before the annual meeting. (See Trans. XII:104-06.) Arthur Young knew at that time that the condensed financial statements were misleading, as Arthur Young noted in its audit workpapers and admitted at trial (CAJA 1240, § V(15); Trans. X:121; XI:125, 146-47).

The 1982 condensed statement came with a meeting agenda that listed "Financial Report . . . of Harry Erwin, C.P.A., Arthur Young & Company." (CAJA 231.) Erwin limited his oral report to "some of the highlights of the condensed statements." In response to "heated and fast and furious" questions from the floor, Erwin corrected no

errors and evaded all questions. (Trans. XII:107-13.) To Judge Waters, "it rather appeared as if the meeting were designed to forestall inquiry that would uncover the truth, rather than for any other reason." (CAJA 64.) According to Erwin's partner Cabaniss, Erwin "responded to the questions, but he did not answer the questions." (Trans. XI:102.)

What Arthur Young Told The Investors In 1983. Again in 1983, the Co-Op consulted Arthur Young regarding the condensed statements; again Arthur Young reviewed drafts before the meeting; again Arthur Young concluded they were misleading; again Arthur Young did not tell the directors the statements were misleading; again the misleading statements were used; and again when Arthur Young (this time Cabaniss) made the presentation to the annual meeting, he spoke only two or three minutes and did not suggest in any way that the condensed financial statements were misleading or reveal that the Co-Op was insolvent. (Trans. XI:147-52, 280.)

What Arthur Young Told The Government. Later in 1983, the United States Department of Agriculture ("USDA"), which could suspend the Co-Op's grain license if it were insolvent, asked Arthur Young about the Co-Op's financial condition. Arthur Young's answering letter, full of jargon and double-talk (CAJA 1261-62), in effect claimed that it was "impossible" to obtain an appraisal or other analysis showing the value of the gasohol plant. (See Trans. X:144-48.) Arthur Young, however, had already done such an analysis. (CAJA 1220.) Also, the directors already had authorized an appraisal, and indeed, repeatedly asked Arthur Young to help the Co-Op find an appraiser. (Trans. XI:276-77; XII:195, 239.) (At trial, all

parties hired appraisers as trial witnesses. (CAJA 1355-56, 1375; Trans. X:147.))

What Arthur Young Told The Board. On April 22, 1982, Arthur Young met the directors, handed them a report, and tried to hurry them to approve it. The directors, realizing how complicated it all was, demurred and asked for additional meetings with Arthur Young. Although they were paid only \$50 a month, the directors attended numerous "special meetings" – five in July alone. (Trans. XI:269-72.) At these and at similar meetings in 1983, as noted above, Arthur Young failed to tell the directors of Arthur Young's three key factual conclusions underlying the carrying value of the gasohol plant. The closest Arthur Young ever came to any matter now at issue was when Arthur Young talked of a "possible" need for a "future" writedown of the value of the gasohol plant, but this was always described as a "future" problem, not one that had to be addressed in 1982 and 1983. (Trans. XII:147-48, 240.) Arthur Young never discussed with the directors the subject of management representation letters (Trans. XI:284), and never disclosed that Kirit Goradia had refused to sign one. (Trans. XI:284-85.)

The Co-Op ultimately declared bankruptcy in February 1984. (JA 260.) Davis, a "new" director who was elected in 1982 and remained in office until the bankruptcy, had such an understanding of the Co-Op's financial condition that Davis owned \$11,000 in Co-Op demand notes at the time of bankruptcy. (Trans. XII:231-36, 241.)

SUMMARY OF THE ARGUMENT

I. We begin by comparing the facts of this case to the plain meaning of the key statutory words. "Affairs" is an all-inclusive term which can include such important activities as raising the funds used by the enterprise to operate and providing an investment service to members (here, the Co-Op demand note program itself). The "conduct" (or "carrying on") of the demand note program can include origination of the Co-Op's fundamental financial data, use of that data to create the Co-Op's financial statements, and reporting on the Co-Op's financial condition to members and investors. "Participate" and "indirectly" have settled meanings of broad compass used for decades to extend liability to persons who assist, aid, share, or associate with primary wrongdoers. Those words together plainly cover an auditor which invents and implements a securities fraud with little help from the issuer's general manager, internal accountant, or directors. The Eighth Circuit and especially the district court opinions are consistent with the above analysis; they, however, conclude that the *dictum* in *Bennett v. Berg*, 710 F.2d 1361 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008 (1983), essentially precludes a RICO action against an auditor.

II. *Bennett* evolved from a brief *dictum* "observation" to a "restrictive" rule apparently requiring proof of "significant control" over "management or operations." As such, *Bennett* is incompatible with several statutory terms ("employed" and "associated," as well as "participate," "indirectly," and "affairs"). By its stringency, *Bennett* prevents RICO from covering exactly what Congress

intended to cover, including most cases of bribery, and raises a host of other insolvable interpretive questions. *Bennett* is not consistent with the holdings in six of the seven other circuits which have addressed the issue. To avoid these problems, the statutory term "conduct" must be construed more broadly than *Bennett* (and *Yellow Bus*) suggest; in any event, whatever meaning is given "conduct," it inherently cannot limit RICO in any relevant manner here given the breadth of "participation" and "affairs."

III. Although petitioners have no reason to criticize other appellate tests, and would prevail under any of them, these other tests have problems which parallel those in *Bennett*. Though not needing to succeed on this point to prevail, petitioners advance an alternative, statutory-language approach.

ARGUMENT

I. A JURY COULD FIND THAT ARTHUR YOUNG "PARTICIPATED" IN THE "CONDUCT" OF THE CO-OP'S "AFFAIRS."

The Racketeering Influenced and Corrupt Organizations Act ("RICO"),⁹ creates a civil remedy, 18 U.S.C. § 1964, for violations of the substantive provisions in 18 U.S.C. § 1962. Section 1962(c) provides in part:

⁹ Title IX of the Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 941.

It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity

18 U.S.C. § 1962(c) (emphasis added).

Two matters are not in dispute. First, RICO defines "racketeering activity" to include federal securities frauds. 18 U.S.C. § 1961(1)(D); *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 481-82 & n.3 (1985). Here the jury found Arthur Young to have "originated" securities frauds and the jury's verdict has now become a final affirmed judgment. Second, the Co-Op is plainly an "enterprise" involved in interstate (including Oklahoma-Arkansas) commerce.

Thus, for the present inquiry, the relevant phrase of the statute can be parsed to yield a question with four parts. Could a jury conclude that Arthur Young (1) did "participate, directly or indirectly," (2) "in the conduct of" (3) the Co-Op's "affairs" (4) "through" the securities frauds Arthur Young originated? Ordering these in the most logical sequence produces:

(A) Did the Co-Op's "affairs" include the demand note program used both to finance the enterprise and to provide a service to members and others wishing to invest their money?

(B) If so, did the "conduct" of the Co-Op's demand note program include origination of financial data, creation of financial statements,

and financial reporting to members and investors?

(C) If so, did Arthur Young "participate, directly or indirectly, in" the conduct of those affairs?

(D) If so, was Arthur Young's participation "through" the securities frauds that were the subject of the jury verdict?

Posed this way, the questions are not difficult to answer:

(A) A jury could find, for two independently compelling reasons, that the Co-Op's demand note program was a major component of its "affairs." First, the sale of demand notes supplied 65%-75% of the Co-Op's total financing. New note sales were constantly needed to replace retired ones. An enterprise's major source of financing, necessary to its survival and requiring continuous activity, can surely be considered part of its business "affairs," which, according to *Black's Law Dictionary* (1951), is "[a]n inclusive term, bringing within its scope and meaning anything that a person may do." Among the specific definitions *Black's* provides is: "A corporation's borrowing money, and methods of obtaining loans." *Id.*¹¹

¹¹ In construing RICO, words with settled meanings should be given controlling effect. "If the statutory language is unambiguous, in the absence of 'a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'" *United States v. Russello*, 464 U.S. 16, 21 (1983) (quoting *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). If there is to be any departure at all from customary meaning, however, "RICO is to be read broadly" in keeping with the statute's explicit

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Without an active demand note program, the Co-Op would not have been able to operate (as ultimately occurred).

Second, the notes were an important service provided to the Co-Op's members. Rural people not regularly travelling near offices of banks or brokers, the members could conveniently invest in demand notes the funds they received when they sold their grain. They also could cash in the demand notes to raise funds when they bought a harvester. Since the nonprofit Co-Op existed only to serve its members, a jury could find such a service to be as much a part of the Co-Op's "affairs" as buying grain or selling fertilizer.

(B) A jury could find that "the act, manner or process of carrying on" (i.e., "the conduct") of the Co-Op's demand note program included the *creation* and *presentation* of the Co-Op's financial information.¹² Significantly, when we speak here of creating fundamental financial data and using it to prepare books, records, and financial

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direction, 18 U.S.C. § 1961 note, to construe the statute liberally in order to effectuate the remedial purposes of the statute and in view of "Congress' self-consciously expansive language and overall approach." *Sedima*, 473 U.S. at 497-83. "Affairs" illustrates Congress' "pattern [of] utilizing terms and concepts of breadth," *Russello*, 464 U.S. at 21.

¹² According to *Webster's Ninth New Collegiate Dictionary* (1983), the noun "conduct" includes "the act, manner or process of carrying on." We comment at greater length in Part II on the improperly restrictive overlays given to "conduct" in the *Yellow Bus/Bennett* test.

statements, we are speaking of what a *company* customarily and necessarily must do in order to have something that can be *subjected* to an audit: *e.g.*, determining whether an asset was bought or whether it was built, and forming (or obtaining) opinions as to valuation and likely recovery of costs. We thus distinguish between what Arthur Young did here and what an auditor does in the course of its job.

A jury also could find that the "conduct" of the Co-Op's affairs include financial reporting to the Co-Op's members and investors. Each year, members were entitled to share in profits (called "net savings"). Members had the sole power to elect directors and thus were entitled to some accounting of finances. Members had to decide whether to invest in the demand note program, and Arthur Young knew such continued investment was vital to the Co-Op's survival.

In sum, the creation of financial information, the preparation of financial statements incorporating such information, and the communication of financial reports to members and investors were essential to the "conduct" of the Co-Op's demand note program. Without the creation of favorable financial information and the reporting of that information to members and investors, the demand note program of the Co-Op, and the Co-Op itself, would have foundered. No one would have invested their money by buying demand notes from the Co-Op had he or she known that the Co-Op was insolvent.

(C) In determining whether Arthur Young did "participate, directly or indirectly, in" the conduct of the affairs described above, the first step is to consider the

word "participate" (and its modifier "indirectly"). Before RICO was adopted, "participate" had an established broad meaning, both generally in the common law, and specifically in federal court explanations of aiding and abetting liability and the law of federal securities frauds (both of which can be viewed as forerunners to and current sources of RICO liability).

In the common law, participate is considered "a word in common usage" which "denotes either active or passive sharetaking." 67A C.J.S. 627 (1978). Although it has various shades of meaning, one "commonly accepted meaning . . . indicates sharing"; another is "to have a part in and to share"; another "connotes to the average person the meaning and effect of 'engage in.'" Also, "[o]ne who takes part in a single action participates therein for the word 'participate' applies equally to a single act or to many acts." *Id.*; accord *Black's Law Dictionary, supra*.

Moving closer to RICO, federal courts have long used "participate" to explain aiding and abetting, often quoting Judge Learned Hand. To aid and abet, Judge Hand wrote, a defendant must "in some sort associate himself with the venture, that he participate in it as something that he wishes to bring about, and that he seek by his action to make it succeed." *United States v. Peoni*, 100 F.2d 401, 402 (2d Cir. 1938), *adopted in Nye & Nissen v. United States*, 336 U.S. 613, 619 (1949). Judge Hand's words continued to be applied after RICO's enactment. *IIT, An Int'l Inv. Trust v. Cornfeld*, 619 F.2d 909, 922 & n.15 (2d Cir. 1980); *Landy v. Federal Deposit Ins. Corp.*, 486 F.2d 139, 163 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974).

Because "participate" is a key word used to explain aiding and abetting, federal courts on occasion elaborate on what it means to "participate." The Fifth Circuit explained that "[t]o prove participation, there must be evidence to establish that the defendant *engaged in some affirmative conduct*; that is, there must be evidence that the defendant committed *an overt act designed to aid in the success of the venture.*" *United States v. Longoria*, 569 F.2d 422, 425 (5th Cir. 1978) (emphasis added).

Securities law violations, predicate acts under RICO, use the term "participant" to describe a person potentially liable for illegal sales. E.g., *Brick v. Dominion Mortgage & Realty Trust*, 442 F. Supp. 283, 306 (W.D.N.Y. 1977). The statutory term "active participants" was held to include not only "[p]ersons participating directly" in a statutory violation but also "those persons who are aware of, and to some lesser degree, participate in a violation of the securities laws and either enter into an agreement with or give assistance to the primary wrongdoers." *Id.* (emphasis added).

Similarly predating RICO is the use of the phrase "directly or indirectly" to modify "participate." In the Securities Act of 1933, an "underwriter" is defined to include a purchaser/seller or any person who "participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking" 15 U.S.C. § 77b(11).¹³ Such language was broadly

¹³ In the same paragraph, Congress used the concept of "controlling" persons when it defined "issuer" to include any
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construed, just before RICO's adoption, to reach "every person who participates in a distribution of securities," not just those "who are engaged in steps necessary" to the distribution. *Securities and Exchange Comm'n v. Van Horn*, 371 F.2d 181, 188 (7th Cir. 1966).

In short, when RICO was adopted, the words "participate" and "indirectly" had meaning in related contexts that suggested breadth, coverage, and extension of liability to secondary participants. To follow that tradition, RICO should cover a person who "shares" in a joint effort, provides "some aid," commits "some act," "engage[s] in some affirmative conduct," "in some sort associate[s] himself with the venture," or "give[s] assistance to the primary wrongdoer." To "participate," one need *not* be "engaged in steps necessary" but may be involved "to some lesser degree."

Returning then to question C, whether Arthur Young did "participate . . . indirectly, in" the conduct of affairs already described, we again stress that this is not a case of the typical auditor, who does nothing more than audit, and perhaps leave unchallenged, fraudulent materials invented and used by an issuer's management as part of their fraudulent scheme.

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person "directly or indirectly controlling or controlled by the issuer." 15 U.S.C. § 77b(11). The words "controlling person" and "participant" apparently were viewed as discrete concepts. See *McCowan v. Sears, Roebuck and Co.*, 722 F. Supp. 1069, 1073-74 (S.D.N.Y. 1989).

Here Arthur Young was the prime mover. Arthur Young invented the fraud. Arthur Young alone decided to pretend that the Co-Op did not buy the gasohol plant, contradicting White's own lawsuit and all existing documents. Arthur Young alone invented the \$4.3 million "cost" figure, pretending that Drozal "independently" determined there were \$4.3 million in construction costs before 1981. Arthur Young alone decided to pretend (and tell the USDA) that an appraisal was "impossible" when the Board had already decided to get one (and had asked Arthur Young to help find an appraiser). Arthur Young alone decided to pretend (and tell the USDA) that an economic analysis was "impossible" when Arthur Young already had done one. Arthur Young alone decided to ignore that analysis, which required an immediate write-down, and pretend that a writedown was a subject for "future" consideration. Arthur Young alone decided not to apply "related-party transaction" procedures. Arthur Young alone persuaded a director to forget about \$150,000 a year in interest in order not to "open a can of worms" – the worms being fraud, falsification of records, perjury, and subornation by colleagues of Arthur Young. Arthur Young alone acted as spokesperson to the Co-Op's members and investors on financial matters and deliberately misled them at two annual meetings.

In all these decisions and actions, Arthur Young barely consulted management or the Board, perpetuating a fraud and coverup contrary to the very reason the "new" directors had sought election to the Board. (Trans. XII:188.) Let us consider, one by one, the only persons other than Arthur Young who *could* have "participated" in the conduct of the affairs described in (A) above.

Former chief executive White, though ready enough to lend his hand to a fraud, went to jail before Arthur Young drafted the first Co-Op financial report and statement. New chief executive Fred Howard was not hired until after the first audit was complete. When he was hired, he was, by agreement, held harmless from responsibility for financial records until the next audit was complete. That was done precisely because Howard was uninvolved in, and uninformed about, prior activities. As between chief executives and Arthur Young, then, the latter was plainly the primary participant.

Next, the closest thing to an internal chief financial officer, "office manager" Goradia, presents the simplest case. When asked, he actively refused, in writing, to accept any responsibility for the Co-Op's financial records or transactions. Arthur Young proceeded knowing of Goradia's disclaimer, which Arthur Young accepted.

Finally, there are the directors, whom Arthur Young met with and had a duty to consult. They were barely informed of anything. They were told the writedown issue was a "future" issue. They were discouraged from getting involved and opening a "can of worms."

In short, Arthur Young crossed the line. It stopped being an auditor and *de facto* made key decisions and took key actions to falsify the Co-Op's records, hide its insolvency, hide the frauds of third parties, fraudulently keep securities sales going, and mislead Co-Op members, Board, and management. Even if the typical (mere) auditor is not covered by RICO, plainly here a jury could find

that Arthur Young "participated," at least "indirectly" in the "conduct" of the "affairs" described in (A), above.

(D) It needs little further discussion to show that what has just been described as Arthur Young's "participation" in the "conduct" of "affairs" was done "through" the securities frauds found by the jury. Arthur Young's frauds were the means to distort the financials, conceal fraud and insolvency from the members, sell demand notes to unsuspecting investors, prevent a "run," and otherwise influence in a fundamental way how the Co-Op did business in a number of significant areas.

The Eighth Circuit and Judge Waters said nothing inconsistent with the above analysis. They drew a different conclusion not through a different analysis, but because they felt bound by an *en banc* opinion of the Eighth Circuit – as to which the trial court said, in granting Arthur Young summary judgment, it is "doubtful that R.I.C.O. questions could be raised against the work of auditors, based on *dicta* in *Bennett v. Berg*." (JA 2.)

Yet the same time the trial court reached this decision, it also recognized the distinct possibility that a jury could find Arthur Young *alone* had perpetrated the entire fraud. The trial court reasoned that Arthur Young could not escape liability under another fraud statute because to do so would mean auditors had effective immunity thereunder, and that was undesirable (CA 181 (emphasis in original)):

If the jury were to find . . . in 1982, that the only persons who were aware that the Co-op was actually insolvent were the accountants and, that out of a misplaced loyalty, the accountants

decided to distort the Co-op's true financial picture, knowing that people were actively investing in the enterprise: does it "make sense" that the only parties who could be held responsible under the law were the directors, whose intent was non-fraudulent? . . . The case against the directors would fall because they had no way of knowing (or suspecting) that accountants would perversely issue a deliberately distorted report The defrauded parties, under this restrictive view [that the state law does not reach auditors], could have no direct rights against the *only* parties responsible for the fraud.

The very thing the trial court refused to do on that other statutory claim, however, was exactly what the trial court felt compelled to do regarding RICO because of the stringent *Bennett* dictum.

II. THE *BENNETT* DICTUM, WHICH EVOLVED WITH LITTLE ANALYSIS, CONFLICTS WITH THE WORDS, PURPOSE, AND REQUIRED "LIBERAL" CONSTRUCTION OF RICO.

The test formulated by the Eighth Circuit (and adopted in altered form by the D.C. Circuit) should be rejected, as it has been by other circuits (six of which have conflicting tests).¹⁴ Only under this test is "conduct" construed to require the defendant to "control" (or "significantly control") the "management or operation" (or "direction" or "course of business") of an enterprise. This requirement (A) evolved with little explanation or analysis; (B) creates many new problems and solves none,

¹⁴ See generally Douglas E. Abrams, *The Law of Civil RICO* § 4.7.3, at 232-42 (1991) (describing tests and collecting cases).

while obstructing the fundamental goal of RICO; and (C) is incompatible with statutory language.

A. The "Control" Test Applied Below Evolved With Little Explanation Or Analysis.

In *Bennett v. Berg*, 710 F.2d 1361 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008 (1983), residents of a retirement village asserted a claim under section 1962(c) against, *inter alia*, the mortgage lender to the village, the village's outside accountants, and in-house counsel for related corporations. The Eighth Circuit, sitting *en banc*, affirmed the dismissal of the complaint with leave to amend. The Eighth Circuit offered several "observations in the interest of aiding the district court and the parties on remand." One observation concerned the degree of participation necessary for liability under section 1962(c): "A defendant's participation must be in the conduct of the affairs of the enterprise, which ordinarily will require some participation in the operation or management of the enterprise itself." *Id.* at 1364. The Court said little about the traditional or customary meanings of any of the statutory terms and gave no effect to the important terms "participate" and "indirectly." It cited no legislative history or rules of construction. It modestly offered an "observation" on how cases "ordinarily" develop.

Bennett was described as a "restrictive" minority view but nevertheless was adopted in *Yellow Bus Lines v. Drivers, Chauffeurs & Helpers Local Union 639*, 913 F.2d 948, 954 (D.C. Cir. 1990) (en banc), cert. denied, 111 S. Ct. 2839 (1991). *Yellow Bus* held that a union, "merely by conducting a recognition strike against an employer," could not be said to "participate" in the conduct of the employer's

affairs. *Id.* at 949, 955. Reaching this plainly sound conclusion required no reliance on *Bennett* (to which the *Yellow Bus* facts bore no resemblance). In its decision, the D.C. Circuit surveyed "divergent" interpretations and decided that *Bennett's* "operation or management" phrasing "hit closest to the mark." 913 F.2d at 952-54. The D.C. Circuit then modified this phrasing several times: first to "management or direction"; later to "guidance, management, direction or other exercise of control over the course of the enterprise's activities." *Id.* at 954.

The "control" language, thus introduced, began to accumulate its own gloss and, eventually, became the essence of the D.C. Circuit reasoning: "As the Eighth Circuit observed, most of the time this requirement will only be satisfied when the defendant, either directly or indirectly, exercises control over the management or operation of the enterprise." *Id.* at 954. Having turned "participation" into "control," the opinion became more restrictive, requiring the "control" to be "significant" and finally defining the "crucial question" as "whether and to what extent that person controls the course of the enterprise's business." *Id.* *Yellow Bus* does not discuss any case regarding, or customary definition of, the terms "participate," "indirectly," or "affairs."

In this case, the Eighth Circuit accepted the praise and description of *Bennett* in *Yellow Bus* (though it is unclear whether the court adopted all that *Yellow Bus* said); agreed with *Yellow Bus* that a majority of other circuits had rejected such a strict test; and then, without offering any defense, rationale, or explanation of *Bennett*, simply held that an Eighth Circuit panel was obligated to follow an earlier *en banc* opinion. In this fashion, without

any real analysis, the statutory phrase "participated, directly or indirectly, in the conduct of the affairs" evolved in two circuits into "exercised significant control over management or operations" or some variant of that.

B. By Using Standards Not Based On Statutory Language, The Bennett Test Creates Many Insolvable Problems And Obstructs The Chief Purpose Of RICO.

One is on no firmer ground with *Bennett/Yellow Bus* than with the statutory language. "Management" could mean only top management or also middle management. If the latter, then it may be enough to participate in only – for example – sales, finance, or pension investments, which seems contrary to the holding below. A "management" test does not explain how close a defendant must come to participating in *all* aspects of management. Similarly, "operations" could include production lines, quality control, or even maintenance. But if it is sufficient to participate in just these matters, there is no benefit in redefining "conduct," and such a redefinition does not limit RICO or warrant the result below. "Control" or "significant control" leaves open the issue "control over what." If one must control all operations, middle management seems excluded. If control must be complete, ultimate, or primary, that goes against the "sharing" and "aiding" ideas in "participate." But if control can be shared, partial, or incomplete, it adds nothing to the analysis to mention it.

Ultimately, of course, one must determine which statutory words support all these glosses in order to answer

the questions raised by them. But then we are back to the statute. A court cannot create a requirement not plainly explicit or implicit in statutory words. See *H.j. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229, 240-41 (1989) (rejecting "multiple scheme" requirement in part because its words "appear nowhere in the language" of section 1962(c)); *Sedima*, 473 U.S. at 495 ("[T]here is no room in the statutory language for an additional . . . requirement.").

Moreover, to the extent any of these glosses have meaning, they plainly push in the direction of confining RICO liability to inside management, top management, and daily managers. They tend to exclude those with outside, intermittent, and shared involvement over parts of operations. In short, they cut exactly against the grain of RICO, undermining the statute's essential purpose.

RICO, much criticized by judges, is beloved of legislatures. For twenty-two years Congress has refused to amend it despite ridicule and pleading by judges of all viewpoints. Meanwhile, numerous states have adopted versions of this criticized statute. State and federal government officials (see *amici* briefs in this case) alike support it and ask for its broad construction. RICO's uniquely draconian provisions and powerful incentives for "private attorney generals" obviously serve a purpose, the essence of which is to multiply the penalties and liabilities of ordinary crimes and torts when the wrongdoer commits his wrongs not just through his own individualized resources but by obtaining the additional resources that come from being able to influence a larger, ongoing, perhaps reputable enterprise.

These policies apply here. If Arthur Young wanted to cover-up White's frauds and defraud the public into continuing to finance the Co-Op for over two years, Arthur Young alone would find it difficult or impossible to do so. The massive fraud committed here on over a thousand persons for over two years could be accomplished only because Arthur Young was able to utilize the resources of the Co-Op – which had been in business since 1946, had thousands of members, enjoyed goodwill with potential notebuyers, had facilities in two states, and had an existing investment program with many actual and potential investors. Arthur Young was able to deceive so many persons for so long only because it could secure the benefit of the Co-Op's resources.

In other words, the *Bennett* test prevents coverage of the paradigm case that RICO seeks to target. It makes RICO inapplicable in the main situation where RICO is designed to apply. By confining "participation" to cases where, *e.g.*, a company president causes his own company to issue securities fraudulently, it confines RICO to situations where defendant uses the resources he already has at his command and does not involve the resources of any other enterprises by participating in their affairs through illegal acts.

C. The *Bennett* Test Is Incompatible With Statutory Language.

A fatal flaw of the *Bennett* test is its incompatibility with several plain, statutory provisions and important applications of RICO such as bribery cases.

Congress included not just "management" but all "employees" of an enterprise under section 1962(c). To define "conduct" to exclude all employees not in management (and, especially, higher management) leaves no room for Congress' broad word to apply. *United States v. Garner*, 837 F.2d 1404, 1420 (7th Cir. 1987), *cert. denied*, 486 U.S. 1035 (1988) ("RICO does not require that the defendants actually manage or operate the enterprise. This court's decisions have held squarely that a RICO defendant need not have a supervisory position in order to violate section 1962(c)."); *Bank of America v. Touche Ross & Co.*, 782 F.2d 966, 970 (11th Cir. 1986) ("It is not necessary that a RICO defendant participate in the management or operation of the enterprise.")

Similarly, Congress included in section 1962(c) all persons "associated with" an enterprise. That is, it included specifically persons who were not employees and did not work full-time for the enterprise (such as auditors). *Bank of America*, 782 F.2d at 970. Nor did Congress require even such outsiders to be associated with top "management." *United States v. Yonan*, 800 F.2d 164, 167 (7th Cir. 1986) ("[T]here is no statutory requirement that . . . persons have contact with policymakers or heads of enterprises before they can be said, to be associated with it."), *cert. denied*, 479 U.S. 1055 (1987); *accord United States v. Mokol*, ___ F.2d ___, 1992 WL 49,796 (7th Cir. Mar. 18, 1992).

Indeed, to confine liability to those who manage the enterprise from inside or who have high-level positions with broad areas of control virtually eliminates RICO's coverage of bribery, which is a specific predicate act under RICO. In *Yonan*, a defense lawyer repeatedly

bribed a prosecutor (plainly committing a pattern of predicate racketeering acts). The Seventh Circuit held that he thereby violated section 1962(c) on "a common sense reading of the term that focuses on the business of the enterprise and the relationship of the defendant to that business." 800 F.2d at 165-67.

Obviously, the briber was not involved full-time with the prosecutor's offices and did not run many of its affairs. He certainly had no role in most cases the prosecutors settled and tried, in hiring and firing their secretaries, in administering their pension and insurance plans, in leasing space for their office, or in most of the office's activities. That will almost always be the case with bribers. To keep them under RICO, as Congress plainly intended, one must conclude that it is sensible usage to say that a briber "participates" in the "conduct" of the "affairs" of the bribee even though all the briber does is pay a series of bribes.

Indeed, the Court employed that usage in dictum in *H.J. Inc. v. Northwestern Bell Tel. Co.*, 492 U.S. 229 (1989). There, the defendant telephone utility allegedly bribed the state public utilities commission that set rates for numerous utilities, including the briber. After deciding a different issue, the Court noted that a section 1962(c) claim could be proven by demonstrating that bribes were the utility's "regular way of conducting or participating in the conduct of the" Commission. 492 U.S. at 250. Presumably when the Court made this statement there was no reason to think the utility had any more power than any typical briber to hire, fire, attend board meetings, supervise other matters, negotiate leases, handle insurance claims, or otherwise "control" or "manage" the

Commission's daily affairs in the way that, say, a vice-president would. The briber had only *de facto* ability to influence, and only as to one small portion of the Commission's total functioning, yet the Court naturally and without hesitation spoke of the briber "participating in the conduct of the" Commission through the bribes.¹⁵

Congress could not have meant to make bribery a predicate act and then adopt a "management-control" test that no briber could ever meet. That is why Congress chose the broad words "participate" and "indirectly," and the secondary-responsibility words "employees" and "associates," all of which traditionally do the job of extending coverage beyond primary, controlling, managing, and central persons.

Thus, the word "conduct," whether used as a verb or as a noun, simply cannot swallow every other word in the critical phrase "conduct or participate, directly or indirectly, in the conduct of the affairs of the enterprise." Even if "conduct" suggests an element of leadership, it must be flexible enough to be satisfied by a briber, by an employee who is not a member of top management, or by

¹⁵ Other RICO bribery cases show that other federal judges use the same language the same way. E.g., *United States v. Blackwood*, 768 F.2d 131, 138 (7th Cir.), cert. denied, 474 U.S. 1020 (1985) (defendant police officer held to "participate" in "conduct" of "affairs" of court when police officer attempted to influence the decision of cases through the solicitation of bribes, falsification of records, use of court offices, and contact with judges); *Mylan Lab., Inc. v. Akzo, N.V.*, 770 F. Supp. 1053, 1081-82 (D. Md. 1991) (drug firms bribed FDA); *United States v. Roth*, 669 F. Supp. 1386, 1388 (N.D. Ill. 1987) (attorney was unsuccessful in attempts to bribe judges).

a non-employee who simply is "associated" with the enterprise. The noun "conduct" must be something that can be "participated in," i.e., shared by several persons, some of whom only "aid" or "assist" the others. Further, the verb phrase "conduct . . . the affairs of the enterprise" (no matter how restrictively it is read) is separated by an "or" from the plainly more expansive noun phrase "participate . . . indirectly, in the conduct of the affairs of the enterprise." Thus, when all the key statutory terms are given life, it is plain that the single word "conduct" cannot be used to limit the reach of RICO to those with "significant control" over the fundamental direction of the entire enterprise.

III. THERE IS A BETTER APPROACH THAN THAT OF BENNETT.

Like the *amici* supporting petitioners, we prefer all of the existing formulations of the courts of appeals to that of the Eighth Circuit. (Among these tests, we favor the Seventh Circuit test.)¹⁶ Indeed, since petitioners prevail under all tests other than *Bennett*, we have no motive to be critical. Nevertheless, the available formulations, as they stand, depart too far from the statutory language for us to urge any of them on the Court. To a degree, they are

¹⁶ *United States v. Horak*, 833 F.2d 1235, 1239 (7th Cir. 1987); *United States v. Pieper*, 854 F.2d 1020, 1026 (7th Cir. 1988). Other tests include *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983) (a variation of the Seventh Circuit's test, adopted by the Sixth Circuit), *cert. denied*, 465 U.S. 1005 (1984), and *United States v. Scotto*, 641 F.2d 47, 54-55 (2d Cir. 1980) (adopted by the Third and Ninth Circuits), *cert. denied*, 452 U.S. 961 (1981).

subject to some of the criticisms raised above against the *Bennett* test.

When RICO creates a new legal concept (such as "through a pattern of racketeering acts"), some judicial gloss may be essential to ensure uniformity of application. However, in those cases, it is hard to avoid using non-statutory words that are no easier to understand than the original statutory words. See *H.J. Inc.*, 492 U.S. at 251 (concurring opinion). Moreover, unless the new words are synonyms, in which case they accomplish little, there is an invariable change in meaning.

In the present case, the most important phrase ("participate, directly or indirectly") has traditional and accepted meanings in related contexts. The words "affairs" and "conduct" are both common and subject to limiting or certain definition. Thus, it may well be wise here to avoid trying to paraphrase the statute. Problems in interpreting the statutory language perhaps can more easily be solved by trial courts on a case-by-case basis, using traditional techniques of statutory construction. First, stipulations and partial summary judgments often can be used to pare away excess verbiage and substitute specific and concrete words for abstract terms in order to focus on what is really at issue. Then, the key terms can be defined, if necessary, using the same settled definitions that would be used in – for example – an aiding and abetting case or statutory securities violation involving the term "participate." Using this straight, statutory approach a trial court might proceed in four phases:

1. Determine whether there is a clearly-defined "enterprise" and whether it is involved in interstate commerce. If these issues are admitted, or so obvious as to be decided as a matter of law, the enterprise's name can be substituted in the issue analysis and the reference to interstate commerce omitted. (Here, for example, this can be done because the Co-Op is an enterprise in interstate commerce.)

2. Based on proof or concessions, it may be possible to drop "conducted or" and use only the "participation" clause. For summary judgment purposes, a court could focus on the "participation" clause on the theory that a plaintiff who cannot prove "participation" would ordinarily fail to prove whatever is required by the prior verb "conduct." The phrase "directly or indirectly" may often be irrelevant on the facts or something the parties might stipulate out of the case.

3. Determine the predicate acts in question and, if possible, whether as a matter of law they would (or would not) form a "pattern" if proved. Substitute those acts for the closing phrase in section 1962(c).

4. For "affairs" the court could consider substituting a concrete description of the portion of the enterprise's affairs that are in fact alleged (or *prima facie* shown) to be at issue.

Applying this approach in this case, for example, a special interrogatory to the jury could be as simple as: "Whether Arthur Young through a pattern of securities frauds participated in the conduct of the Co-Op's

demand note program." So reduced, the question is manageable and comprehensible, whether for summary judgment purposes or for a jury. Unlike the problem with the novel "through a pattern of racketeering" language at the end of section 1962(c), there is no pressing need to rephrase the familiar concepts in the "participation" portion of the statute. It does not help to add additional gloss, whether "control" and "management" (Eighth and D.C. Circuits), "enabled" and "involvement" (Second Circuit), or "facilitated" and "effect" (Seventh Circuit). Such words do not aid a jury, or a district judge, in analyzing the statutory requirements. But, worse, the tests raise more questions than the statutory language because their words use terms that do not have meanings as clear, settled, and customary as the words Congress chose.

CONCLUSION

The Eighth Circuit should be reversed. The case should be remanded to the district court for summary judgment proceedings or trial to determine whether Arthur Young, through a pattern of securities frauds, conducted or participated, directly or indirectly, in the conduct of the affairs of the Co-Op. The district court can

resolve that issue using whatever guides and interpretations the Court ultimately adopts.

Respectfully submitted,

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